



DATE: June 3, 1998

TO: John F. Bovenzi
Director
Division of Resolutions and Receiverships

FROM: Stephen M. Beard
Director
Office of Congressional Relations and Evaluations

SUBJECT: *Book Value Reductions for Loans Held by FDIC National Servicers (EVAL-98-002)*

The Office of Congressional Relations and Evaluations (OCRE) has terminated its review of book value reductions for loans held by FDIC national servicers during 1997. We terminated this review because we found that FDIC had exceeded its 1997 target for book value reductions for loans held by national servicers. We also determined that the book value reductions achieved during the fourth quarter of 1997 were mainly attributable to a bulk sale of loans, not asset write-offs unrelated to sales. Further, we verified that the book value reductions for these loans were supported by FDIC's general ledger system.

We initiated this review based on information in the Corporation's *Third Quarter 1997 Performance Report*, which indicated that the FDIC had only achieved 30 percent of its targeted book value reductions for loans held by national servicers. In addition, we had previously noted in our report EVAL-97-001, *Workload and Staffing at the Southeast Service Center's Division of Depositor and Asset Services and Liquidation Branch*, dated February 27, 1997, that the disposition rate for loans held by outside servicers appeared low at that time.

During the initial stages of our review, the Corporation's *Fourth Quarter 1997 Performance Report* was issued. The report indicated that \$418 million of book value reductions had been achieved during the fourth quarter for loans held by national servicers. We determined that the book value reductions were mainly attributable to a bulk sale of loans, including those held by one of FDIC's national servicers. Based on the fourth quarter 1997 information, we do not believe that any further work in the area of book value reductions for loans held by FDIC national servicers is warranted at this time.

Our draft of this report did not include recommendations. Thus, a formal response from management was not required. Nevertheless, we did provide a draft of the report to cognizant Division of Resolutions and Receiverships (DRR) officials to: (1) verify the accuracy of the facts presented, and (2) obtain management's views on our observation relating to differences between book value reductions reported in one of DRR's monthly activity reports and the book value reduction information presented in FDIC's *Fourth Quarter 1997 Performance Report*. The DRR officials agreed with the facts and observations presented in our report. DRR's response, which was transmitted via electronic mail, is included in its entirety as an Appendix to this report.

OBJECTIVES AND SCOPE OF REVIEW

When we initiated this review, our objective was to evaluate the Corporation's book value reductions for loans held by national servicers. To accomplish our objective, we held an entrance conference and individual interviews with managers in DRR and the Office of Internal Control Management. In addition, we obtained and analyzed numerous DRR and Division of Finance (DOF) reports related to loan sales, collections, and write-offs.

Upon receiving the updated book value reduction information in the *Fourth Quarter 1997 Performance Report*, we curtailed our review and limited our work to identifying the composition of the book value reductions reported for national servicers. In light of our prior report on a Southwest Service Center fourth quarter 1996 asset write-off case, EVAL-97-013, *Review of Southwest Service Center Asset Write Off Case 450-10110-96-ROI*, dated December 9, 1997, we believed it was important to identify the extent to which the book value reductions were attributable to loan write-offs.¹

We conducted our review between March 27, 1998, and April 27, 1998, in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

BACKGROUND

The Government Performance and Results Act (GPRA) of 1993 requires executive agencies to develop strategic plans that define agency missions, establish results-oriented goals, and identify strategies to achieve these goals. To comply with GPRA, FDIC prepares an annual Performance Plan which implements the Corporation's Strategic Plan and defines what will be accomplished during the year to achieve the strategic goals and objectives. The Corporation evaluates its program performance through a quarterly performance reporting process.

FDIC's 1997 *Annual Performance Plan* included a performance goal to achieve \$3.9 billion in book value reductions by year-end 1997. At the end of the fourth quarter 1997, DRR had achieved \$5.174 billion in book value reductions for all assets in liquidation, or 132 percent of the target for 1997. DRR was expected to achieve \$489 million of the \$3.9 billion in book value reductions for the loans serviced by its national servicers in 1997, but had achieved only 30 percent of this goal by the end of the third quarter of 1997. However, at the end of the fourth quarter of 1997, DRR had achieved \$563 million in book value reductions, or 115 percent of the 1997 target for loans serviced by FDIC national servicers. Book value reduction measures are tracked through FDIC's general ledger system, the Financial Information Management System (FIMS), and the National Processing System, a subsidiary ledger for liquidation asset tracking. In addition, DRR prepares monthly activity reports

¹ Evaluation Report No. 97-013 presented the results of the OIG's review of a Hotline complaint related to a Southwest Service Center asset write-off case approved in December 1996. The most serious allegation in the complaint was that assets were written off to meet 1996 book value reduction goals with the intent of rebooking them in 1997. We determined that the write off case was prepared in an effort to remove assets with no recovery value from the Corporation's books and to achieve 1996 book value reduction goals. The OIG determined that seven of the 23 assets written off were rebooked in 1997. These assets were incorrectly written off and later rebooked. The OIG saw no evidence that there was an intention to rebook the assets at the time they were written off.

related to DRR field operations, receivership activities, assets in liquidation, composition of loan and owned real estate portfolios, and collections and sales. These monthly activity reports are available on FDIC's Intranet.

OBSERVATIONS

Book Value Reductions

In December 1997, DRR's Franchise and Asset Marketing Branch completed a bulk sale of assets called "Bulk Sale PCM1," which included loans serviced by BancOne, one of FDIC's national servicers. Most of the book value reductions that took place in the fourth quarter 1997 were attributable to this bulk sale. Specifically, the sale of BancOne loans accounted for \$475.1 million of the \$509.5 million in total gross book value reductions that occurred in the fourth quarter of 1997 for the national servicers.

As shown in the following table, the sale resulted in approximately \$413 million of sales proceeds and nearly \$52 million in loan principal written off.

	Fourth Quarter	Bulk Sale PCM1/BancOne
Principal Losses (write-offs)	\$ 55.3 million	\$ 51.6 million
Principal Collections (non-sales)	41.3 million	10.6 million
Principal Collections (sales)	412.9 million	412.9 million
Gross Book Value Reductions	\$509.5 million ^a	\$475.1 million

^a FDIC reported \$418.2 million in net book value reductions for the fourth quarter 1997, which reflects \$509.5 million in gross reductions offset by nearly \$91.3 million of participation transactions and corporate purchase valuation loss offsets.

FDIC tracks the book value reduction target through FIMS, FDIC's general ledger system. We reviewed a DOF-generated report, which listed the journal entries posting the Bulk Sale PCM1 sales proceeds to the pertinent general ledger accounts. We verified that the amounts in the table above, obtained from DRR and DOF reports, were supported by the journal entries.

DRR Activity Reports

We reviewed DRR's monthly activity reports for December 1997 and found that most of the reports reflected either the \$563 million in book value reductions achieved in 1997 for the loans serviced by the national servicers, or the \$5.174 billion in book value reductions reported for all FDIC assets in liquidation. However, we reviewed one report, entitled "ASSETS IN LIQUIDATION BY ASSET TYPE AND BY FUND," that reflected total book value reductions of \$4.008 billion compared to \$5.174 billion reported in the *Fourth Quarter 1997 Performance Report*, a difference of \$1.166 billion. This report also showed a December 31, 1997, balance of \$4.859 billion assets in liquidation versus the \$4.115 billion balance reported in the *Fourth Quarter 1997 Performance Report*.

The DRR monthly activity reports, such as the one referenced above, are available on FDIC's Intranet pages. It is important that information available to other divisions and offices be consistently accurate. Accordingly, we suggested that DRR research why the information presented in the performance report differed from the Intranet information and take appropriate action based on its findings.

DRR agreed that there were errors in a table that was posted to the DRR Intranet summary. DRR was not able to determine how the errors occurred or what caused the errors to occur. DRR has, however, already implemented a new process for moving data into the tables that DRR believes should prevent errors of this type from occurring in the future. DRR's response adequately addresses our suggestion.

CONCLUSIONS

Based on the initial results of our review, we discontinued our evaluation of book value reductions for loans held by national servicers. Our preliminary review showed that DRR book value reductions for loans held by servicers exceeded the 1997 year-end target. Further, we determined that the book value reductions were mainly attributable to a bulk sale, not write-offs unrelated to sales, and were supported by the Corporation's general ledger system.

APPENDIX

APPENDIX

CORPORATION COMMENTS

May 21, 1998

Memorandum To: Ann R. Lewis
Office of Congressional Relations and Evaluations

From: Giovanni G. Recchia
Division of Resolutions and Receiverships

Subject: Response to Review of Book Value Reductions Report

Thank you for the opportunity to respond to the draft of the subject report. We are pleased that the information we provided you for your initial review was responsive to your requests. We have reviewed the draft report and only have comments on one issue. Those comments are as follows:

DRR Activity Reports

DRR agrees that there were errors in a table that was posted to the DRR Intranet summary. DRR has not been able to determine how the errors occurred or what caused the error to occur. DRR has, however, already implemented a new process for moving data into the tables that should prevent this type of error from occurring in the future.

Should you need any additional information, please call me at extension 86973. Thank you.